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Federal Communications Commission
Office of Secretary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington D.C. 20554

In the Matter of	)	
	)	
Implementation of the	)	
Telecommunications Act of 1996	)	CC Docket No. 96-150
	)	
Accounting Safeguards under the	)	
Telecommunications Act of 1996	)	

OPPOSITION/COMMENTS OF BELLSOUTH
TO PETITIONS FOR RECONSIDERATION

BellSouth Corporation, on behalf of itself and its subsidiaries ("BellSouth"), hereby files these oppositions to and comments on the Petitions for Reconsideration in the captioned proceeding. Public notice of the filing of the petitions was given in the Federal Register on March 18, 1997, 62 Fed. Reg. 12830. Eight parties filed petitions.[1] For the reasons set forth below, BellSouth supports, in whole or in part, the petitions of Ameritech, CBT, GTE, SBC and SNET. BellSouth opposes the remaining petitions.

This docket arose out of the requirements of the Telecommunications Act of 1996 for accounting safeguards to protect subscribers of existing telecommunications services from subsidizing incumbent local exchange carrier ("ILEC") entry into new markets.[2] At the same time, Congress clearly intended that the Commission adopt regulations that are consistent with the

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[1] Petitions were filed by American Public Communications Council ("APCC"), Ameritech, Cincinnati Bell Telephone Company ("CBT"), Cox Communications, Inc. ("Cox"), GTE Service Corporation ("GTE"), MCI Telecommunications Corporation ("MCI"), SBC Communications, Inc. ("SBC"), and Southern New England Telephone Company ("SNET").
[2] See, e.g., 47 U.S.C. § 260(a)(1): "Any local exchange carrier subject to the requirements of section 251(c) that provides telemessaging service--(1) shall not subsidize its telemessaging service directly or indirectly from its telephone exchange service or its exchange access...." See also 47 U.S.C. § 272(c)(2); 47 U.S.C. § 273(g); 47 U.S.C. § 275(b)(2); 47 U.S.C. § 276(a)(1).

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overall deregulatory, pro-competitive intent of the 1996 Act. In new Sections 10 and 11 of the Communications Act, Congress expressly required the Commission to review and eliminate unnecessary regulation. For the reasons set forth below, BellSouth believes that some of the requirements adopted in the captioned proceeding are unnecessarily regulatory without countervailing public benefit, and therefore should be reconsidered.

I. Services provided by LECs solely to members of the corporate family should be booked at fully distributed cost.

CBT, SNET and Ameritech petitioned the Commission to allow services provided on a centralized basis by the telephone company solely to members of its corporate family to be valued at fully distributed cost for accounting purposes. These companies note that when the telephone company provides services to members of the corporate family at fully distributed cost, significant benefits accrue to subscribers through economies of scale and scope.[3] Requiring these services to be priced at the higher of cost or fair market value will discourage these otherwise beneficial affiliate transactions[4] and will require affected LECs to undertake expensive fair market value studies for every such affiliate transaction that serve no business purpose and which will burden ratepayers.[5] Furthermore, if services provided by the telephone company to a services affiliate are valued at the higher of cost or fair market value, and the services company then bills its cost back to the LEC at fully distributed cost, the unintended result is higher cost to the regulated company and its customers.[6]

[3] SNET at 4; CBT at 3.
[4] CBT at 4; SNET at 5.
[5] SNET at 4; CBT at 3-4.
[6] Ameritech at 3-4.

BellSouth agrees that LECs should be allowed to provide centralized services to other members of their corporate family without triggering the asymmetrical valuation requirements of the new rules. As BellSouth demonstrated in its comments in this proceeding and in Docket 93-251, the requirement to perform fair market value studies in addition to fully distributed cost studies adds millions of dollars annually of administrative cost to the LECs with no appreciable consumer benefit. While the creation of the service company exception eases the burden of the new rules for most carriers, there remains a substantial layer of new costs that will be imposed on all LECs, and their ratepayers, as a result of the new requirements adopted in this proceeding.[7] As requested by SNET, CBT and Ameritech, the Commission should expand the services company exception to permit services provided by a telephone company exclusively to members of the corporate family to be valued at fully distributed cost without the necessity of performing fair market value studies.

II. BellSouth supports GTE's request for additional flexibility in applying prevailing market price to value services transactions.

GTE notes that it has two affiliates that together have over $345 million in annual sales to non-affiliates in highly competitive markets. Nevertheless, these sales do not qualify for the prevailing market price test because they represent less than 50 percent of the total sales of these affiliates. GTE asserts that sales at this level clearly are sufficient to insure that the prices charged for these products and services are not excessive.[8] GTE asserts that it will incur increased

[7] For rate of return companies, these additional costs will be borne directly by ratepayers. Even for price cap companies, these new administrative costs meet the test for exogenous treatment under the price cap rules, and therefore will result in increases in the price cap indices of affected LECs.

[8] GTE at 5.

administrative costs of over one million dollars a year if it cannot use the prevailing market rate method to value these transactions.[9]

BellSouth agrees that the 50 percent sales threshold to qualify to use prevailing market price should not be rigidly applied, and that the alternatives set forth by GTE in its petition are sufficient to ensure that ratepayers will suffer no harm as a result of the affiliate transactions between GTE and its affiliates.[10] The Commission should adopt a liberal waiver policy with regard to the 50 percent threshold where carriers can demonstrate that a lower level of sales is sufficient to ensure that the price charged to the LEC by its affiliates is reasonable.[11]

III. The issues raised by SBC have merit.

SBC raises several issues that have merit, and warrant reconsideration by the Commission. The Commission's extension of the affiliate transaction rule, 47 C.F.R. § 32.27, to transactions between the nonregulated activities of the LEC and a nonregulated affiliate were not included in the notice of proposed rulemaking issued by the Commission and therefore were not lawfully adopted in this proceeding.[12] Furthermore, the rule extension makes no sense, and is entirely duplicative of the existing protections afforded by the Part 64 rules. Under Part 64, a carrier must

[9] GTE at 2-3.
[10] GTE at 6.
[11] While BellSouth agrees that GTE should be afforded relief from the 50 percent threshold to apply the prevailing price test, BellSouth strongly disagrees with GTE's assertion that the 1996 Act "concluded that the public interest requires extraordinary burdens on the BOCs and far less onerous burdens on Independents." GTE at 23. The 1996 Act was intended to be deregulatory for all carriers. GTE is larger than any of the BOCs and is far more geographically dispersed, making state regulatory oversight of GTE more difficult than for the BOCs. Other than the specific requirements imposed on the BOCs to replace the former MFJ restrictions, and the special provisions relating to small, rural telephone companies, Congress treated all incumbent LECs the same in the 1996 Act. There is nothing in the 1996 Act that implies that Congress intended different accounting rules for the BOCs and the other incumbent LECs.
[12] SBC at 3-4.

allocate its costs between regulated and nonregulated operations. This requirement is more than sufficient to protect ratepayer interests. To require carriers also to apply § 32.27 to transactions between a carrier's nonregulated operations and a nonregulated affiliate is entirely redundant. Such unnecessary regulation is patently contrary to the deregulatory principles of the 1996 Act. The Commission should reconsider this requirement and grant the relief sought by SBC.

BellSouth also agrees with SBC's objection to the Commission's new tactic of treating competitive regulated services as nonregulated solely for federal accounting purposes.[13] Pulling these costs out of regulation prior to jurisdictional separations, as is done under the Commission's Part 64 rules, deprives the Commission and the state commissions (for intrastate services) of the accounting detail usually used for ratemaking purposes that are derived from Part 36, 61 and 69 based databases. Furthermore, as SBC points out, it is inherently arbitrary to treat these services as "deregulated" for accounting purposes only.[14] If the Commission wants to guard against cross-subsidy by removing the cost of these services from regulation, it should adopt a forbearance order under Section 10 of the Communications Act.

BellSouth agrees with SBC that the "chain transaction" principle is not applicable if the prevailing price method applies to transactions between a LEC and its affiliate.[15] BellSouth did not read the Order as implying any modification of the existing chaining principle, but agrees with SBC that if the Commission intended to change the application of the chaining principle, it should reconsider that decision. The existence of a prevailing market price makes it unnecessary and inappropriate to consider the cost of producing the product or service in question. It would be

[13] SBC at 6-9.
[14] SBC at 7.
[15] SBC at 10.

totally arbitrary to require LEC affiliates operating in highly competitive, unregulated markets to incur the cost of performing fully distributed cost studies when those studies are not being used in the regulatory process.

BellSouth agrees with SBC that the Commission's broad interpretation of Section 61.45(d)(1)(v) is both illogical and inconsistent with price cap principles. If a service earning a normal rate of return is deregulated, the removal of the revenue, expense and investment associated with that service from regulation should have no effect on the prices of the services that remain subject to price cap regulation. Yet under the Commission's interpretation, an exogenous cost adjustment to remove the investment from the rate base results in a downward price cap index adjustment. Such a result is contrary to the theory of price cap regulation and creates perverse incentives on the part of the LECs to keep regulated services that otherwise warrant deregulation. The more limited interpretation of Section 61.45(d)(1)(v) that was advanced by the LECs, i.e., that it applies only in the case of an incorrect forecast of regulated and nonregulated investment, is both consistent with price cap theory and the fundamental economics of regulation. The Commission should reconsider its application of this rule.

BellSouth also supports the substance of SBC's request concerning the Section 274(f) reporting requirement for separated affiliates. The Securities and Exchange Commission itself applies to wholly-owned subsidiaries a different reporting standard than a full Form 10-K. In General Instruction J to Form 10-K, "Omission of Information by Certain Wholly-Owned Subsidiaries," the SEC has adopted reduced reporting requirements for wholly-owned companies. Many of SBC's requests are covered by this rule. For example, the instruction explicitly allows wholly-owned filers to omit Item 4, "Submission of Matters to a Vote of Security Holders"; Item

6, "Selected Financial Data"; and Items 10-13, dealing with director and officer compensation and security ownership. It also allows significant reductions in required disclosures on Item 1, "Business"; Item 2, "Properties"; and Item 7, "Management's Discussion and Analysis." In addition, as SBC points out, the SEC does not always require audited financial statements in its official filings. Based on the SEC's own rules, the Commission can and should determine what parts of the Form 10-K reporting requirements are necessary to meet the "substantially equivalent" requirement of the Act for annual reports from Section 274 separate affiliates.[16]

IV. The petitions of APCC and Cox are repetitious and otherwise without merit and should be dismissed.

APCC seeks reconsideration on two issues: the Commission's decision: 1) not to require the BOCs to maintain separate books of account for their nonregulated payphone service activities; and 2) its decision not to apply the affiliate transaction rules to asset transfers between the Bell companies' regulated operations and their integrated nonregulated payphone operations.[17] APCC concedes that it raised these identical issues in CC Docket No. 96-128 and that it is currently appealing from an adverse order in that proceeding.[18] Under such circumstances, its petition for reconsideration in this proceeding is repetitious, and should be dismissed.

In any event, the issue raised by APCC is premised on the fallacious assumption that the accounting treatment required by the Commission for regulatory purposes will carry over to the

[16] While BellSouth agrees with the substance of SBC's position on the Form 10-K, BellSouth believes that it and other LECs can take advantage of General Instruction J under the existing Commission order, and therefore, reconsideration is not necessary for a LEC separated affiliate to take advantage of the reduced reporting requirements permitted under General Instruction J. To the extent that SBC's Exhibit "A" goes beyond what is already permitted by General Instruction J, BellSouth supports SBC's request for reconsideration.
[17] APCC at 1.
[18] APCC at 3.

financial books of the LEC's payphone operations. This is simply incorrect. Whether the LECs choose to operate their deregulated payphone operations as a separate, unregulated division within the LEC or to create a separate, unregulated payphone affiliate, Generally Accepted Accounting Principles require that the assets transferred be recorded at net book cost. Thus, APCC's request that the Commission require that the nonregulated operations carry the value of location contracts and goodwill on their balance sheets[19] will not occur in any event.[20] Since the Commission cannot grant the relief requested by APCC, its reconsideration petition should be dismissed.

The petition of Cox is equally without merit. Rhetoric aside, Cox's petition is premised on a fundamentally flawed assumption: as competition increases, so must regulation. To the contrary, Congress intended that regulation be eliminated as competition increases.[21] Cox also asks the Commission to follow tentative conclusions from notices in other proceedings over the record-based findings reached in CC Dockets 96-149 and 96-150.[22] Cox has it exactly backwards. Here the Commission has found, based on a substantial record, that the structural and nonstructural safeguards it has adopted are sufficient to protect both ratepayers and competitors. Concerns expressed in other proceedings, prior to the development of the record, form no basis for reconsideration in this proceeding. To the contrary, the Commission's findings in this proceeding should inform its decisions in dockets that are still pending.

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[19] APCC Attachment 2, p. 7.
[20] Even if the LEC creates a separate affiliate to conduct its payphone operations, as has BellSouth, the separate affiliate's books will, in accordance with GAAP, reflect the value of the assets transferred from the LEC at net book cost.
[21] See 47 U.S.C. §§ 10, 11.
[22] Cox at 3-4.

Cox also launches an unsubstantiated attack on the Commission's reporting requirements, despite the fact that these requirements were not at issue in this proceeding.[23] Clearly, since the Commission cannot modify its reporting requirements on reconsideration in this proceeding, Cox's petition for reconsideration must be denied.

V. Granting MCI's request would violate the requirements of the 1996 Act.

MCI asks the Commission to reconsider its conclusion that products and services offered by the LEC to its Section 272 affiliate subject to Section 272(c)'s nondiscrimination requirement are exempt from the 50 percent outside sales threshold for prevailing market price. MCI argues that the BOCs could tailor their products and services to the needs of their Section 272 affiliate and that such services would be "useless to third-party customers."[24] MCI cites marketing, research and development, and administrative services as examples of services falling into this category.

MCI's concerns are without substance. The Act's nondiscrimination requirements are far more potent than the affiliate transaction rules in deterring cross-subsidy. In order to subsidize its Section 272 affiliate, a BOC would have to offer a product or service below cost to all comers on the same terms and conditions. This requirement will naturally constrain a BOC's pricing decisions.

MCI seems to assert that the exemption from the 50 percent threshold in Paragraph 137 of the Order allows the BOCs to price services to its affiliates on an unrestrained basis. However, Paragraph 137 does not amend the affiliate transaction rules generally. It simply means that where a BOC sells products or services to third parties that are within the scope of the Section

[23] Cox at 6-9.
[24] MCI at 3.

272(c) nondiscrimination requirements, there is a rebuttable presumption that these rates represent a prevailing company price.[25] Obviously, if the BOC created a unique product or service for its Section 272 affiliate that was "useless" to third parties, the presumption of a prevailing market price would be easily rebutted. MCI's concerns are without merit.

Accepting MCI's proposal to apply the 50 percent threshold to transactions between the BOC and its Section 272 affiliate would prevent compliance with the nondiscrimination requirement of Section 272(c). The Act and the Commission's decision in CC Docket No. 96-149 require that the BOC provide facilities and services to all parties on a non-discriminatory basis. If the affiliate transaction rules required that the BOC charge its affiliate a different price than that charged to all other customers, the non-discrimination requirement could not be met. Hence, the terms and conditions under which the BOCs provide facilities or services to their external customers must also apply to their Section 272 affiliate. Setting a price, publicly disclosing that price, and providing that same service to all external customers at that price certainly meets the definition of an "arm's length" transaction better than the imposition of an arbitrary benchmark. MCI is simply seeking a means to gain an unearned competitive advantage over the BOC's Section 272 affiliate. The Commission should reject MCI's petition for reconsideration.

[25] Obviously, services that are exempt from the nondiscrimination requirement, such as joint marketing, are not subject to the Paragraph 137 exception, and the otherwise applicable affiliate transaction rule still applies.

VI. Conclusion.

The Commission should grant the petitions for reconsideration filed by Ameritech, CBT, GTE, SBC and SNET. It should deny the petitions of APCC, Cox and MCI.

Respectfully submitted,

BELLSOUTH CORPORATION
By its Attorneys:

M Robert Sutherland

William B. Barfield
M. Robert Sutherland
BellSouth Corporation
Suite 1700
1155 Peachtree Street, N.E.
Atlanta, GA 30309-3610

(404) 249-4839

April 2, 1997

CERTIFICATE OF SERVICE

I Julia W. Spires, do hereby certify that I have this 2nd day of April 1997, serviced all parties to this action with the foregoing "OPPOSITION/COMMENTS OF BELLSOUTH TO PETITIONS FOR RECONSIDERATION" reference CC DOCKET 96-150, by hand delivery or by placing a true and correct copy of the same in the United States Mail, postage prepaid addressed to the parties as set forth on the attached service list.

Julia W. Spires

Julia W. Spires

SERVICE LIST OPPOSITION COMMENTS CC 96-150

Jack B. Harrison, Esquire
Frost & Jacobs
Attorneys for Cincinnati Bell Telephone Company
2500 PNC Center
201 East Fifth Street
Cincinnati, Ohio 45202

Office of the Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington D.C. 20554

Ernestine Creech
Common Carrier Bureau's Accounting and Audits Division - FCC
2000 L Street, N.W. - Suite 257
Washington, D.C. 20554

International Transcription Service
Suite 140
2100 M Street, N.W.
Washington, D.C. 20554

David L. Meier, Director
Legislative & Regulatory Planning
Cincinnati Bell Telephone Company
201 E. Fourth Street
Cincinnati, Ohio 45202

Thomas E. Taylor, Sr. Vice President
General Counsel
Cincinnati Bell Telephone Company
201 East Fourth Street, 6th Floor
Cincinnati, Ohio 45202

Wendy S. Bluemling
Director - Regulatory Affairs
SNET
227 Church Street
New Haven, CT 06510

Verner K. Hartenberger
Laura H. Phillips
Christina H. Burrow - Attorneys for
Cox Communications, Inc.
Dow, Lohnes & Albertson, PLLC
1200 New Hampshire Avenue, N.W. - Suite 800
Washington, DC 20036

Alan N. Baker
Attorney for Ameritech
2000 West Ameritech Center Drive
Hoffman Estates, IL 60196

Richard McKenna, HQE03J36
Attorney for GTE Service Corporation
P. O. Box 152092
Irving, TX 75015-2092

James D. Ellis
Robert M. Lynch
David F. Brown
Attorneys for SBC Communications, Inc.
175 E. Houston, Room 1254
San Antonio, TX 78205

Gail L. Polivy
Attorney for GTE Service Corporation
1850 M Street, N.W.
Suite 1200
Washington, D.C. 20036

Alan Buzacott
Don Sussman
Attorneys for MCI Telecommunications Corp.
1801 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

Durward D. Dupre
Jonathan W. Royston
Attorneys for Southwestern Bell Telephone Co.
One Bell Center, Room 3520
St. Louis, MO 63101

Albert H. Kramer
Robert F. Aldrich
Dickstein Shapiro Morin & Oshinsky LLP
Attorneys for American Public Communications Council
2101 L Street, N.W.
Washington, D.C. 20554-1526

Michael K. Kellogg
Jeffrey A. Lamken
Kellogg, Huber, Hansen, Todd & Evans
Counsel for the RBOC Payphone Coalition
1301 K Street, N.W. - Suite 1000 West
Washington, DC 20005